United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-7038

To be argued by
EDWARD J. ROSS

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United States Court of Appeals
For the Second Circuit

75-7038, 75-7055, 75-7057

HOWARD BERSCH,

Plaintiff-Appellee,

against

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL AND CO., LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & CO. INCORPORATED, J. H. CRANG AND CO., INVESTORS OVERSEAS BANK LIMITED,

Defendants,

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Defendants-Appellants.

Appeal from the United States District Court for the Southern District of New York

REPLY BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

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REPLY BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

A. Two Relevant Decisions Rendered Subsequent to Andersen's Main Brief

The vigilance of appellate courts in making certain of subject matter jurisdiction or existence of a proper class before proceeding with the merits of a case is exemplified by two relevant decisions rendered since February 3, 1975, the date of Andersen's main brief.

(1) *United States* v. *Franklin National Bank, decided February 24, 1975.* — Plaintiff, seeking to distinguish *Snyder* v. *Harris,* 394 U.S. 332 (1969) and *Zahn* v. *International Paper Co.,* 414 U.S. 291 (1973), states that "sales

to American residents in America may bring the entire transaction within the ambit of the federal securities laws so as to encompass all class members who choose to be included in the class'' (Br. 89).* However, on February 24, 1975, in *United States* v. *Franklin National Bank* (Slip Op. p. 1891), this Court rejected an argument that because plaintiff Todel, an equity receiver appointed by the District Court at the instance of the government, could personally have a federally-created right, there was subject matter jurisdiction over any cause of action he might bring. This Court there stressed the necessity for ''an independent basis for jurisdiction'' (p. 1902), repeating that ''an independent jurisdictional basis is necessary'' (p. 1899); that ''there must be independent jurisdictional grounds'' (p. 1900); and that ''an independent jurisdictional ground would be necessary'' (p. 1901).

Subject matter jurisdiction there appeared so clear that its possible absence escaped even the seasoned Court of Appeals Judge designated to sit in the District Court, and subject matter jurisdiction was also assumed to exist by the parties, including the distinguished law firm which represented appellant. And ''[I]t was not until oral argument before us, when Judge Friendly raised the question in open court, that the parties focused on the jurisdictional issue'' (p. 1896).

Here, subject matter jurisdiction has been basic to the case from the outset. Here, Andersen has consistently argued that there is no ''independent basis for jurisdiction'' over foreign class members.

(2) *The Board of School Commissioners* v. *Jacobs, decided February 18, 1975.*—This Supreme Court decision (43 LW 4238) is relevant to plaintiff's contention that on June 28, 1972, Judge Frankel made a ''class action determination'' (Br. 2, fn.) based on his statement that ''The

* References herein to ''Br.'' and ''A.Br.'' are, respectively, to Plaintiff's Brief and Andersen's Main Brief.

action may be maintained as a class action on behalf of all purchasers of IOS shares in the 'IOS Public Offering', as detailed in the complaint, of 10,992,000 shares beginning in September 1969'' (84A) (Br. 13).

Plaintiff, however, ignores the subsequent statement by Judge Ryan, made December 5, 1973, that Judge Frankel ''didn't enter any class order. He defined no class * * *. Therefore, what he said was dictum'' (192A).

Since this aspect is covered in Andersen's brief (A. Br. 6, 70-75), it is mentioned here only because of such Supreme Court decision in *Board of School Commissioners,* rendered two weeks after Andersen's brief, which supports its position and Judge Ryan's statement.

In *Board of School Commissioners,* the District Court had found that certain named plaintiffs no longer had standing, but that ''the remaining named plaintiffs are qualified as proper representatives of the class whose interest they seek to protect (349 F.Supp. 605, 611 (S.D.Ind. 1972)'' (p. 428), a general statement substantially similar to Judge Frankel's (84A).

Apparently no one in the District Court or in the Court of Appeals (*Jacobs* v. *Board of School Commissioners,* 490 F.2d 601 (7th Cir. 1973)) questioned the District Court's statement as being a class action determination. The Supreme Court, however, questioned it *sua sponte,* and found ''inadequate compliance with the requirements of Rule 23(c),'' stating (43 LW 4238-9):

> ''The only formal entry made by District Court below purporting to certify this case as a class action is contained in that court's 'Entry on Motion for Permanent Injunction,' wherein the court 'conclude[d] and ordered' that 'the remaining named plaintiffs are qualified as proper representatives of the class whose interest they seek to protect.' 349 F. Supp., at 611. No other effort was made to identify the class or to certify the class action as contemplated by Rule

> 23 (c)(1); nor does the quoted language comply with the requirement of Rule 23 (c)(3) that '[the] judgment in an action maintained as a class action under the subdivision . . . (b)(2) . . . shall include and describe those whom the court finds to be members of the class.' * * * Because the class action was never properly certified nor the class properly identified by the District Court, the judgment of the Court of Appeals is vacated and the case is remanded to that court with instructions to order the District Court to vacate its judgment and to dismiss the complaint."

Judge Frankel also merely made a general statement comparable to the District Court's statement in the *Jacobs* case, without, however, making a formal entry, or certifying the case as a class action, or identifying the class, or certifying the class action as contemplated by Rule 23(c)(1). And, as Andersen has already pointed out (A. Br. 6), a notice of a class action determination was not sent following Judge Frankel's opinion of June 28, 1972, and was not even proposed to be sent until 2½ years later, in December 1974, when it was included in a proposed notice of compromise under Rule 23(e), (287A-295A),—the notice stayed by this Court.

B. Misstatements in Plaintiff's Brief Which Destroy Its Credibility

Plaintiff's basic approach is to misstate facts; to distort the record; to make statements not supported by the cited record references or which grossly misrepresent the record; to state as facts matters not fairly deducible from the record; and to make statements for which no record references are cited, since there is nothing to support such statements. The foregoing has been done to an extent which causes plaintiff's brief to lose credibility. Its principal misstatements and distortions will be noted seriatim.

(1) *Size of Class.*—Plaintiff retreats from his former position, as alleged in the complaint (6A), that there are

100,000 class members. He now states that "discovery has revealed" certain facts on the basis of which "plaintiff now estimates that the class has approximately 25,000 members" (Br. 5).

In accordance with Judge Ryan's order of April 2, 1973 (93A), all discovery as to jurisdiction and class representation issues was completed before September 1, 1973. Yet on December 5, 1973, plaintiff's lawyer represented to Judge Ryan that he was still seeking "to represent a hundred thousand purchasers of IOS stock throughout the world" (191A-192A). It was only after *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974) that he apparently decided it was strategic to reduce the class from 100,000 members to 25,000 members, which he has now done based on his own *ipse dixit*.

(2) *Date of Plaintiff's Purchase.*—Plaintiff now denies that he bought his stock on September 3, 1969, three weeks before the public offerings, and states that "his purchase was made on September 24, as part of the Public Offering" (Br. 3). However, he concedes that he subscribed for his stock on September 3, 1969 (Br. 2-3) and, though his brief ignores this fact, the record shows that he paid for his stock on September 3, 1969 (47A-1). Moreover, Judge Carter's opinion, which plaintiff describes as "careful, well-reasoned" (Br. 17), expressly finds that "plaintiff's purchase of I.O.S. shares does not appear to have been made in reliance on statements in the Crang prospectus, since that prospectus was sent to the United States after the date of the purchase" (273A),—a statement applicable to all three IOS prospectuses.

(3) *Plaintiff's American Residency as a Bar to Purchase.*—Plaintiff argues that he "did not practice deception upon defendants" in purchasing IOS stock since his subscription showed his United States address (Br. 3). But this is not responsive to his being *in pari delicto* as to violation of the SEC restriction against sale to American residents. Plaintiff's deception lay in his even subscribing for

IOS stock since, as he conceded in his Answers to Interrogatories, he was "aware of the consent order regarding I.O.S., Ltd. entered by the Securities and Exchange Commission on May 23, 1967" (34A, 44A) which prohibited sales to resident citizens. Plaintiff's awareness of the SEC order refutes his contention that he had "no personal basis for believing the sale to him to be illegal" (Br. 4).

Plaintiff's rationalization that he did not entrap a clerk in the IOS Geneva office, because "The form letter [as to the interest equalization tax] was not signed by a clerk, but rather a member of the IOS legal department" (Br. 4) is specious. This letter, dated January 15, 1970, over four months after his purchase, was not addressed to plaintiff at his New York address but is merely a printed form addressed to "Dear Shareholder" (47A-3). This form letter hardly signifies that an IOS lawyer had approved a sale to him as a resident citizen, despite the SEC prohibition of May 23, 1967 (192A-113).

(4) *Number of Resident American Purchasers.*—Plaintiff misstates the record when he asserts that there were "46 Americans residing in the United States who purchased IOS stock at the IOS Public Offering" (Br. 4, 7). The documents cited are letters dated September 17, 1970 (226A), October 20, 1970 (129PA) and December 15, 1970 (228A-1).

However, many Americans working for IOS abroad returned to the United States after its collapse in April 1970. Their addresses, used in correspondence in September, October and December 1970, do not establish their domestic residency on September 24, 1969, the offering date. The only Americans who the record shows may have bought IOS stock in September 1969 while residents of the United States, are the eleven listed in Bersch's hearsay affidavit of May 12, 1972 (73A), of whom four were also sellers of IOS stock (74A).

(5) *The Alleged Need to Register the IOS Stock.*—Plaintiff's brief asserts that "defendants were informed

that sales to United States citizens, even abroad, would violate an Order prohibiting IOS from selling securities to Americans and would require the entire offering to be registered'' (Br. 18). This is not, and could not be, the case, since the SEC Order could not have more explicitly authorized sales outside the United States ''to officers, directors and full-time personnel of IOS and its subsidiaries'' (192A-113).

It was so clear that the offering did not require registration and was outside the federal securities laws that this was recognized in a staff memorandum dated February 16, 1970 to Representative Wright Patman, Chairman of the House Committee on Banking and Currency, contained in the Hearings on ''Foreign Bank Secrecy and Bank Records'' referred to by plaintiff (Br. 64). The Report of the House Committee Hearings on H.R. 15073 (91st Cong., 1st and 2d Sess.) states (pp. 184-5):

> ''The financial data on IOS and its mutual fund management, banking and other financial activity, real estate, and insurance operations in subsequent sections of this report were obtained principally from IOS Prospectus dated September 24, 1969, because the secrecy under which IOS is operated precludes obtaining information from more objective sources. *This prospectus was for the sale of IOS, Ltd., stock outside the United States, hence, it did not come under the review of the Securities and Exchange Commission.*''*

(6) *The Alleged IOS Office in New York.*—Plaintiff, to give IOS a domestic flavor, states that ''IOS * * * maintained an office on Madison Avenue in New York (73-PA)'' (Br. 10). This statement is false. IOS, a foreign corporation with its principal office in Geneva, did not maintain an office in New York or anywhere else in the United States. Plaintiff's cited reference (73PA) is to an SEC letter to Shearman & Sterling, dated June 6, 1969, which not only does not support plaintiff's statement as to the alleged

* Unless otherwise noted, italics have been added.

Madison Avenue office but, insofar as it deals with IOS' place of business, merely states that "Its principal business activities are assertedly located" in Switzerland (73 PA).

(7) *The Alleged Subterfuge of Using IOB to Evade the SEC Order of May 23, 1967.*—Plaintiff states that "since it was the intention of the defendants to sell IOS stock to United States nationals * * * and since IOS was prohibited from selling its securities to Americans," such sales to Americans "were delegated to IOB, an IOS subsidiary, having little or no assets" (Br. 23-24). The inference is that IOB was used to circumvent a prohibition applicable to IOS.

However, the SEC order of May 23, 1967 applies to "IOS and all of its affiliates," so that obviously IOB could not be used to circumvent the SEC order. But even more significant is the fact that such order expressly authorized sales to United States citizens "outside of the United States" if made to "officers, directors and full-time personnel of IOS and its subsidiaries" (192A-113).

The IOB separate offering covered this special category of authorized sales, as clearly stated in the IOB prospectus, which noted on its cover page that the offering was not registered and was not being made in the United States, its territories or possessions, or in Canada or Mexico, and that it was limited to such IOS non-resident insiders, including Americans (184A).

(8) *Misstatement as to Judge Carter's Finding.*—Plaintiff's brief, without citing any reference to his opinion, states that Judge Carter made a "finding" that "defendants were informed that sales to United States citizens, even abroad, would violate an Order prohibiting IOS from selling securities to Americans and would require the entire offering to be registered" (Br. 18).

Judge Carter made no such finding. His sole reference to this subject matter is that "Murphy [of Shearman & Sterling] was put on warning as to potential application of a 1967 SEC prohibitory order to I.O.B. sales to Americans" (264A),—an order which, as already noted, authorized sales "outside of the United States" to American "officers, directors and full-time personnel of IOS and its subsidiaries" (192A-113).

(9) *Misstatements as to Andersen's Preparing Financial Statements.*—Plaintiff's brief particularly misstates the facts as they relate to Andersen,—since the underwriters, who have arranged to settle the $110,000,000 claim against them for $700,000, with at least a $200,000 fee to plaintiff's counsel, plus at least $10,000 for disbursements (Br. 11-12, 292A-294A),—now appear to have common interests with plaintiff.

Thus, plaintiff's brief misstates and misleads when it asserts that "Andersen *prepared the financial statements* and other data which portrayed IOS as a thriving, growing concern whose financial affairs were in order and being prudently managed" (Br. 8),—a statement unaccompanied by record reference. Plaintiff's counsel must know that a corporation's outside accountants do not prepare its financial statements. The financial statements are prepared by a corporation's internal staff. The outside accountants make an audit and express an opinion as to whether the financial statements have been prepared in accordance with generally accepted accounting principles. (See 179A).

It is not clear as to what the words "other data" refer to, since Andersen's function was limited to expressing its opinion as to financial statements which had already been prepared by IOS' internal accounting staff.

(10) *Andersen's Alleged Important Role in Preparing the Prospectus.*—Plaintiff states that Andersen "played such an important role in the *preparation of the prospec-*

tus'' (Br. 73-4). This statement is false, since Andersen did nothing in connection with "preparation of the prospectus." The prospectuses were prepared solely by the issuer, the underwriters and their respective counsel. Andersen simply consented to use in the prospectuses of its opinion as to IOS' 1968 financials, rendered on April 15, 1969, before the public offerings were even contemplated. (See A.Br. 22-29).

(11) *Misstatement of the Number of Meetings Attended in the United States by Andersen.*—Plaintiff states (Br. 17):

> "1. Representatives of IOS, major underwriters, their attorneys and accountants met in New York *on numerous occasions* in order to initiate, organize and structure the Public Offering".

This implies that the accountants, Andersen, also "met in New York *on numerous occasions*". The documents relied on, however, show that there was only one principal meeting in New York at which Andersen representatives were present; namely, the meeting of June 1969, at which there was discussion whether Andersen could complete an audit of the June 30, 1969 financial statements,—the so-called "stub period",—in time for the September 1969 offerings (208A-25).* Werblow of Price, Waterhouse thought that Tiffert of Andersen also participated in a meeting the following day "to discuss more of the specifics as to what Arthur Andersen could do in connection with the June 30, 1969 financials" (208A-100).

Plaintiff makes it appear that Andersen attended more than this one principal meeting in New York and, accordingly, uses the transcript of Werblow's deposition twice, listing it as both No. 18 and No. 30 of a list of 70 items of alleged activity in the United States (Br. 41, 43). (See

* Plaintiff stresses and repeats that this meeting lasted ten hours (Br. 8, 19, 55-6). However, Ruegger, of Andersen, made it clear that his part of the meeting was at the most 3½ hours in the morning session only (208A-85; 208A-87; 208A-88).

pp 18-19, *infra.*) It will be noted that No. 18 of this list, which is also Document 18 of plaintiff's Appendix II in the District Court dealing with a meeting of June 24, 1969 (Br. 41) attended by Andersen representatives (208A-24–26), and No. 30 of this list, which is also Document 30 of Appendix II allegedly dealing with a meeting of July 11, 1969 (Br. 43) (208A-82–84) attended by Andersen representatives, are identical and, in both cases, are pages 49-51 of the deposition of Werblow, of Price, Waterhouse.

(12) *Misstatements as to Alleged Errors in Andersen's Work.*—Plaintiff further misstates when he refers to "errors in Andersen's work which reflected adversely upon IOS' financial condition" (Br. 8); to "obvious defects in Andersen's work" (*id.*); and to "deficiencies in defendant Andersen's financial report of IOS' affairs" (Br. 19). These three references all relate to a list of 36 questions prepared by Price, Waterhouse for discussion with Andersen's representatives. Plaintiff's reliance on such 36 questions was anticipated in Andersen's brief (A.Br. 28-29), except that Andersen could not anticipate the extent of plaintiff's distortions and misuse of this material.

This list of 36 questions did not even purport to refer to alleged "errors in Andersen's work" or alleged "defects in Andersen's work" or alleged "deficiencies" as falsely stated in plaintiff's brief. It was merely a list of 36 questions to be asked Andersen as to the stub period ending June 30, 1969, because insufficient time remained for Andersen to audit that period. As Murphy of Shearman & Sterling testified, Price, Waterhouse was asked "to come up with all the questions they could in regard to the financials, in regard to the accounting procedures, so that Drexel people could satisfy themselves as to the extent they could on the accuracy of the stub period" (93A-1).

Andersen's work related to the audit of the financials as of December 31, 1968, and prior periods, whereas the 36 Price, Waterhouse questions were all addressed to the stub period as to which Andersen could not make an audit within the allotted time.

(13) *The Distortion and Misuse of the 36 Questions Asked by Price, Waterhouse as an Alternative to an Audit of the Stub Period.*—Plaintiff further distorts the import of the list of 36 Price, Waterhouse questions discussed at either the June or July meeting in New York and uses this list in two separate and unrelated contexts. These 36 questions are in a Price, Waterhouse memorandum with each question given a separate consecutive arabic number (215A-219).

As already noted, this list of questions is falsely referred to in plaintiff's brief as a review by Price, Waterhouse of "the deficiencies in defendant Andersen's financial report of IOS's affairs" (Br. 19), following which plaintiff's brief lists six "Typical questions raised by Price, Waterhouse at the aforesaid meeting in New York",—which plaintiff refers to as having taken place both on June 24, 1969 (Br. 41, Item 18) and on July 11, 1969 (Br. 43, Item 30). In the case of each of the six questions plaintiff uses the arabic number, as used by Price, Waterhouse, namely, paragraphs 8, 15, 16, 27, 31 (erroneously listed as 32), and 36 (Br. 20).

In June or July 1969, when Price, Waterhouse asked its 36 questions, the Drexel prospectus had not yet been prepared. However, since the final prospectus was dated September 24, 1969, there must have been a printer's proof in existence earlier that month. Accordingly, with the designated heading, September 10, 1969, plaintiff's brief states that Price, Waterhouse had uncovered many "illegal practices" and had "alerted the defendants, in New York, that the prospectus was false and misleading", and that Price, Waterhouse had made "typical comments" of which eleven separate paragraphs were then set forth (Br. 46, Item No. 45).

The matter is thus presented as though Price, Waterhouse,—having seen a proof of the prospectus on September 10, 1969,—told the underwriters that the "prospectus was false and misleading", because of the questions listed

in the brief. The eleven paragraphs, there set forth without arabic numbers, are, in fact, paragraphs numbered 3, 7, 8, 14, 16, 23, 27, 30, 31, 32 and 33 of the 36 Price, Waterhouse questions submitted in June or July 1969, long before any draft of a prospectus, and asked as an alternative to an Andersen audit of the stub period.

The arabic numbers were obviously here deliberately dropped to conceal the fact that these are the same Price, Waterhouse questions, and [illegible]ake it appear that such firm had con[illegible]up with something [illegible] applicable to the prospectus its[illegible]—though it is hard to understand how plaintiff could have expected Andersen's counsel not to readily perceive such patent deception.

(14) *Misstatement as to the Number of Shares of IOS Stock Purchased by Americans.*—Plaintiff grossly exaggerates in stating, without record reference, that 1,507,578 shares were purchased by Americans, and that such purchases constituted approximately 13.7% of the total shares sold (Br. 7). Actually, only 844,683 shares were bought by Americans, of which 662,895 were acquired by IOS Foundation of Delaware (160PA), which were evidently bought for the benefit of a Bahamian affiliate of IOS (216PA-217PA).* Also, 39,400 of such shares were bought by IOS directors (227A-228A; 229A; 131PA; 133PA).

Accordingly, eliminating shares purchased by IOS Foundation, in one affiliated transaction, and by IOS directors, there remain 142,388 shares sold to Americans, all of whom were affiliated with IOS. Such shares constitute 1.3%, rather than 13.7%, of the total offering.

(15) *The Misstatement That Andersen Refused to Have a Joint Appendix.*—Plaintiff, to prejudice Andersen, blames it for absence of a Joint Appendix, stating that it "refused to print the documents designated by plaintiff" (Br. 3, fn.).

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* Plaintiff's figure of 1,507,578 was arrived at by counting the IOS Foundation block of 662,895 shares twice.

Though this Court's Order of January 7, 1975 seems not to require a Joint Appendix, since this is an expedited appeal, nevertheless Andersen's counsel, by letter dated January 13, 1975, sent all counsel his list of documents and requested designation of additional documents for a Joint Appendix. Though plaintiff's lawyer wanted Andersen to include "all documents" in its Appendix II in the District Court, which consisted of several hundred pages, other than those already designated by Andersen's counsel (Letter, dated January 16, 1975), he refused to specify them, placing on Andersen's counsel the entire selection burden. Accordingly, Andersen's counsel wrote plaintiff's counsel on January 17, 1975, that "Your designations not only preclude prompt agreement, but *burden us with ascertaining what documents you want*".

Included in the material plaintiff wanted reproduced in a Joint Appendix are two chapters, totalling 76 printed pages, from a book on Bernard Cornfeld and IOS written by three journalists, entitled "Do You Sincerely Want To Be Rich", upon which the complaint is apparently based. How such a book could have probative value was never made clear by plaintiff's counsel, who insisted on these two chapters being before this Court. Accordingly, they are now included in his Appendix (186PA-230PA).*

It is for the foregoing reasons only that Andersen's counsel did not proceed with a Joint Appendix.

Though many more misstatements and distortions of fact in plaintiff's brief could be set forth, the foregoing should suffice to establish the accuracy of the statement made at the outset as to the nature of plaintiff's brief (pp. 4-5, *supra*).

Pertinent is the comment in *Ryan* v. *Cortland Carriage Goods Co.*, 133 App. Div. 467, 470, 471 (3d Dept. 1909), that:

* It may be parenthetically noted that this book of 389 pages makes only three minor references to Andersen as auditors for IOS (pp. 275, 295, 299), and only one is in connection with the three offerings (p. 275).

> "A brief of this character, instead of being an aid to the court in determining the questions involved, furnishes no aid whatever, because suspicion must naturally rest upon every statement asserted as a fact in it and little reliance be placed upon a brief so made, * * *."

C. The Elimination from Andersen's Brief of Its Position That Rule 23(b)(3) Is Invalid

Plaintiff twice refers to the fact that Andersen sought permission to file a 120-page brief, which would include "an earnest presentation of an issue of tremendous importance and far-reaching consequences, namely whether Rule 23 is invalid" (Br. 2, fn. 16). Although this issue was not raised below, Andersen wanted to raise it on appeal, under the settled principle that a court will consider issues not raised below which "are of great significance" (*Greene* v. *Brown,* 398 F.2d 1006, 1009 (2d Cir. 1968)), or where "there are significant questions of general impact" (*Krause* v. *Sacramento Inn,* 479 F.2d 988, 989 (9th Cir. 1973)).

Because Andersen had only approximately three weeks for its brief, it was impossible to move for permission to file a longer brief with "a copy of the page proofs * * * two weeks before the brief is due", as now required by the Court's Rule 27(f). Andersen's motion was made on Friday, January 31, 1975, when the final page proof was ready, and the Clerk advised that under the circumstances of an expedited appeal this was timely. It was not until 3:30 p.m. on February 3, 1975, that Andersen's counsel learned that his brief could not exceed 75 pages. The only changes which could feasibly be made, without disrupting this Court's schedule for the appeal, was to excise the "Summary of the Argument", which is optional and the portions dealing with the invalidity of Rule 23(b)(3).

Plaintiff's brief misleads when it states that Andersen's brief "was filed one day late" (Br. 16, fn.). While it was

impossible to print and file the brief on February 3, 1975, since Andersen's counsel only learned of the Court's order at 3:30 p.m., plaintiff's counsel was served that day by hand with the excised page proof. Accordingly, he had the full time for response directed by this Court's order of January 7, 1975.

Andersen's counsel was anxious to present to this Court such issue of invalidity of Rule 23(b)(3). It was eliminated from Andersen's brief not because deemed unsound or expendable, as plaintiff seems to suggest, but merely as the most feasible method, in the few hours available, of complying with this Court's order of February 3, 1975 limiting Andersen's brief to 75 pages.

However, if this Court is prepared to consider the invalidity issue, Andersen's counsel would welcome the same opportunity to submit a post-argument brief on the subject as was accorded in *United States* v. *Franklin National Bank, supra* (pp. 1-2); in *United States* v. *D'Amato*, 507 F.2d 26 (2d Cir. 1974); and in *Leasco Data Processing Equipment Corp.* v. *Maxwell*, 468 F.2d 1326, 1330 (2d Cir. 1972).

D. Plaintiff's Position That the Underwriters Have a Strong "Due Diligence" Defense Warranting Settlement of a $110,000,000 Claim for $700,000

While plaintiff refers to his settlement with the six underwriters of the $110,000,000 claim for $700,000 (Br. 11-12),—or substantially less than 1% of the claim,—under which his counsel seeks a fee of $200,000 and disbursements of $10,000 to date of settlement, with a right to seek a higher fee for additional work and reimbursement for further disbursements (292A-294A), it is not clear why he regards this settlement as bearing on the issue of subject matter jurisdiction.

Plaintiff's counsel justifies his settlement as "reached only after discovery revealed a sufficient basis for plaintiff to evaluate the 'due diligence' defense which was available

only to the settling defendants'' (Br. 12, fn.),—implying that plaintiff has a much stronger case against Andersen because it could not have a ''due diligence'' defense. The sham nature of this assertion,—which further affects the credibility of plaintiff's brief,—is patent.

First, discovery was limited to matters bearing on jurisdiction, not the merits of a ''due diligence'' defense. Plaintiff's brief makes this clear in its list of all the areas of discovery (Br. 14).

Second, the ''due diligence'' defense is available only under Sections 11 and 12 of the 1933 Act, whereas this purports to be a Section 10(b) case under the 1934 Act.

Third, Section 12 of the 1933 Act contains a strict privity requirement that liability runs only from the offeror or seller ''to the person purchasing such security from him''. Since Andersen was neither an offeror nor a seller, it could in no event have any liability under Section 12, and hence it would be immaterial that Andersen may not have a ''due diligence'' defense.*

Plaintiff's brief in suggesting such weakness in his case against the six underwriters because of their ''due diligence'' defense (Br. 12 fn.), elsewhere takes a position diametrically opposed. Thus, referring to a meeting of Price, Waterhouse representatives with Coleman and Ambrose, officers of defendant Drexel, and their counsel, Murphy of Shearman & Sterling, plaintiff states that the accountant they employed, Price, Waterhouse, ''alerted the defendants [referring to Drexel], in New York, that the prospectus was false and misleading'' (Br. 46).

Then,—again referring to information allegedly furnished Drexel by Price, Waterhouse,—plaintiff's brief

* Since the complaint does not mention Section 11 of the 1933 Act, and since Section 11 applies only to a false registration statement,—and in this case there is no registration statement,—the "due diligence" defense of Section 11 would be unavailable to the settling defendants as well as to Andersen.

states that "defendants [the underwriters and IOS], nevertheless, determined to go forward with the offering despite conclusive evidence that the company was not a proper one for investment by the public", and argues that, apart from any alleged misrepresentations in the prospectus, "the actual underwriting, itself, was a fraud" (Br. 56). Yet plaintiff asserts that the underwriters have a good "due diligence" defense, whereas Andersen is one of "the principal wrongdoers" (Br. 12, fn.).

E. Plaintiff's Effort to Show Subject Matter Jurisdiction

Though plaintiff's position as to subject matter jurisdiction has already been refuted in Andersen's brief (A.Br. 31-68), a few additional comments are in order.

(1) *"Activity" in the United States.*—Plaintiff urges extraterritorial application of the American securities laws to sales of stock of a foreign corporation, made abroad to non-resident aliens, on the basis of "a more sophisticated jurisdictional calculus" (Br. 29). But his basic effort is somehow to fit *Schoenbaum* v. *Firstbrook*, 405 F.2d 200 (2d Cir. 1968) or *Leasco*.

The *Schoenbaum* requirement cannot be met since there is no need here "to protect domestic investors who have purchased foreign securities on American exchanges",—the basis of subject matter jurisdiction in *Schoenbaum** (405 F.2d at 206).

In *Leasco*, subject matter jurisdiction was not based on mere meetings in New York, but on meetings at which key misrepresentations were made directly to the plaintiff. In an effort to come under *Leasco*, plaintiff presents a list of 70 items of "activity" in the United States, primarily

* Similarly, the SEC claimed jurisdiction in *Arthur Lipper Corp.*, 1970-71 CCH Fed.Sec.L.Rep. ¶78,126 (SEC 1971), on which plaintiff relies (Br. 34, fn.), because "the very securities transactions" there involved "were effected on the United States over-the-counter markets."

relating to various meetings, telephone conversations and correspondence (Br. 36-50). However, none of such meetings has any relationship to the fraud charged by plaintiff in the later public offerings; or meets the *Leasco* test of "abundant misrepresentations in the United States" or of "fraudulent acts in the United States" (468 F.2d at 1335); or involves representations made to plaintiff or to any member of his alleged class.

The flimsy and deceptive nature of plaintiff's list of 70 items, partly shown above, may be further illustrated by additional examples.

Item No. 66 states that "United States facilities for international travel were utilized. (See, for example, 118 PA)" (Br. 50), as though subject matter jurisdiction may depend on whether someone flew to Geneva by Pan American rather than Swissair. Moreover, the cited document merely lists expenses for trips between New York and Geneva, Paris or London, without indicating whether the flight was on an American or foreign airline (118PA).

Item No. 55 states that on October 13, 1969 Knowlton had lunch with Arthur Lipper and another (Br. 49) (96-98PA),—as though lunching with someone, without any indication of what was discussed at lunch, could support subject matter jurisdiction. Knowlton's deposition testimony as to his alleged lunch with Lipper is as follows (98PA):

> "Q. Was Mr. Lipper also present?
> "A. Possibly * * *.
>
> "Q. Did you invite Mr. Lipper to be present?
> "A. I don't think so".

While listing 70 items of alleged activity in the United States,—the nature of which is illustrated by such possible Lipper luncheon and such alleged flights on domestic airlines,—plaintiff's brief ignores the substantial work abroad, as described in Andersen's brief (A.Br. 11-18).

Plaintiff's brief also ignores the impact of SEC Release No. 33-4708 and 34-7366, dated July 9, 1964,—stressed in Andersen's brief,—which makes it so clear that it is immaterial "whether the offering originates from within or outside the United States, whether domestic or foreign brokerage dealers are involved, and whether the actual mechanics of the distribution are effected in the United States, so long as the offering is made under circumstances reasonably designed to preclude distribution or redistribution of the securities within, or to nationals of, the United States". The steps taken by all the underwriters to assure compliance with such "reasonably designed to preclude" requirement as set forth in Andersen's brief (A.Br. 11-18), are not questioned by plaintiff.

(2) *The Fact of There Being American Citizens in the IOS Management.*—A further basis asserted by plaintiff in support of subject matter jurisdiction is that, even though IOS is a foreign corporation, with its office abroad and no office in the United States, "its image" was allegedly American (Br. 73-4; also Br. 8-9, 10, 27-28). But under such SEC Release it would not matter even if all the officers were American citizens and resided in the United States, with their offices here, and constituted the management of a United States corporation, so long as the offering is a foreign one which meets its "reasonably designed to preclude" requirement.

(3) *Plaintiff's Reliance on Antitrust Decisions to "Fathom the Congressional Purpose".*—Plaintiff concedes that "there is no express statutory language which defines the international reach of the securities laws, and the legislative history of the statutes gives little hint as to precisely what Congress intended", and states that "the courts are left to fathom the Congressional purpose" (Br. 75). Plaintiff then contradicts this by stating that "The specific language of the Securities Exchange Act, as well as its legislative history, indicate that Congress intended the securi-

ties laws to encompass foreign transactions *having an impact in this country*'' (Br. 76-77). Accordingly, plaintiff relies heavily on alleged adverse effect of the IOS collapse on the American economy and the American securities market. His brief is replete with assertions, unsupported by any evidence, that the IOS collapse adversely affected the ''reputation of American securities markets'' and ''the confidence of foreign investors'', and tarnished the ''United States' market image'' (Br. 60-61).

The brief then relies on antitrust cases,—particularly *United States* v. *Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945) and *United States* v. *Watchmakers of Switzerland Information Center, Inc.*, 1963 CCH Trade Cases (¶70,600 (S.D.N.Y. 1962)),—to support the position that subject matter jurisdiction exists ''where foreign conduct caused adverse consequences within'' the United States (Br. 75), or where ''conduct on foreign soil by foreign defendants * * * had materially noxious consequences within the United States'' (Br. 58).

Plaintiff's brief misstates both the *Aluminum Co.* and *Watchmakers of Switzerland* cases, both of which are clear to the effect that repercussions or effects within the United States of foreign conduct outside the United States will not suffice to create subject matter jurisdiction under the antitrust laws,—absent a specific intent to create such repercussions or effects within the United States.

In the *Aluminum Co.* case, which involved two agreements, made in 1931 and 1936, respectively, this Court stated that such agreements, though made abroad, would be unlawful ''if they were *intended to affect imports* and did affect them'' (p. 444). Thus, the combination of both intent and effect is needed to create subject matter jurisdiction. Since in the *Aluminum Co.* case, the 1931 agreement was not intended to cover imports, this Court felt that ''we may ignore it and confine our discussion to that of 1936'' (p. 444).

And this Court there further stated (p. 443):

> "There may be agreements made beyond our borders not intended to affect imports, which do affect them, or which affect exports. Almost any limitation of the supply of goods in Europe, for example, or in South America, may have repercussions in the United States if there is trade between the two. Yet, when one considers the international complications likely to arise from an effort in this country to treat such agreements as unlawful, *it is safe to assume that Congress certainly did not intend the Act to cover them*".

Similarly, even assuming all plaintiff's [illegible]ague and hypothetical inferences that collapse of IOS, or perhaps collapse of any of the issuers or obligors under five billion dollars of off-shore Eurobonds (see A.Br. 52-4), might have repercussions in the United States, the *Aluminum Co.* case, on which plaintiff places so much reliance, is clearly inapplicable.

Leasco also made it clear that alleged adverse effect on the American securities market does not suffice to sustain subject matter jurisdiction, absent specific intent to cause such effect (468 F.2d at 1334):

> "If all the misrepresentations here alleged had occurred in England, we would entertain most serious doubt whether, despite United States v. Aluminum Co. of America, 14[illegible] 2d 416, 443-444 (2 Cir. 1954), and *Schoenbaum*, §10(b) would be applicable simply because of the adverse effect of the fraudulently induced purchases in England of securities of an English corporation not traded in an organized American securities market, upon an American corporation whose stock is listed on the New York Stock Exchange and its shareholders."

As this Court further stated in *Leasco* (p. 1334):

> "The language of §10b of the Securities Exchange Act is much too inconclusive to lead us to believe that Con-

gress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security'' (468 F. [illegible] 1334).

Similarly, in the *Watchmakers* case, *supra*, the very intent of the conspiracy there alleged was ''to restrict, eliminate and discourage the manufacture of watches and watch parts in the United States and to restrain United States imports and exports of watches and watch parts for both manufacturing and repair purposes'' (p. 77,416). It was only because of such purpose that the District Court found that there was ''a substantial and material effect upon our foreign and domestic commerce'' (p. 77,457).

Here, plaintiff does not claim, and cannot claim, that the purpose of the offerings and the alleged conspiracy was to adversely affect the United States securities market. Plaintiff's position simply is that the effect was to impair the American image; to discourage non-resident aliens from buying stock in American companies; '' 'to undermine investor confidence in America and abroad in United States securities' '' (Br. 28), quoting his ''expert'', Mendelson; and to increase redemptions of shares in mutual funds, with consequent sale of American securities to raise funds to pay the redemption price (Br. 54-5). But since such alleged effects were not the purpose of the three offerings, under the *Aluminum Co.* case, *supra*, such alleged effects are insufficient to sustain subject matter jurisdiction.

And, when one considers the complications from seeking to apply the federal securities laws to protect non-resident aliens, because the United States' image might be adversely affected by their losses, ''it is safe to assume that Congress certainly did not intend'' the 1933 and 1934 Acts to cover such non-resident aliens.

(4) *Plaintiff's Position That Dismissal for Lack of Subject Matter Jurisdiction Would Adversely Affect This*

Country's Balance of Payments.—Finally, plaintiff suggests that subject matter jurisdiction should be sustained because the IOS collapse would "have a significant effect upon the balance of payments of the United States" (Br. 67; also 68-69). However, the contrary is true. If subject matter jurisdiction is sustained and plaintiff conceivably recovers the $110,000,000 here sought, only then would this country's balance of payments be adversely affected.

Except for plaintiff and possibly eleven other American residents, who plaintiff's affidavit suggests may also have purchased in the United States (73A), the remaining IOS shareholders all bought abroad with Eurodollars, paying almost $110,000,000 for their stock. If the requested judgment for $110,000,000, plus interest, should be obtained, the judgment may have to be paid by the American defendants in United States dollars. Since over 99.6% of the members of the alleged class are non-resident aliens, living in Europe, Asia, Africa, Australia and South America, there would necessarily be a flow from the United States to such countries of the $110,000,000, plus interest, which obviously would adversely affect the United States balance of payments.

F. The Court's Inherent Power as to the Class Action Determination

As shown in Andersen's brief (Point IV), it is clear beyond doubt that a resident citizen cannot represent a class, over 99.6% of which consists of non-resident aliens, and that this Court has broad power on an interlocutory appeal to dispose of this question, so intimately related to the issue of the reach of the securities laws. Plaintiff has declined to consider this question, making the flat statement that "Where an interlocutory appeal is taken, the appellate court will not go any further into the merits of the case than is necessary to decide the matter on appeal" (Br. 94). This erroneous statement of the law, which is not supported by any of the seven authorities cited by plaintiff (Br. 94),

ignores this Court's recent holding in *Capital Temporaries Inc. of Hartford v. Olsten Corp.*, 506 F.2d 658 (2d Cir. 1974),—an interlocutory appeal under 28 U.S.C. §1292(b), —that:

> "Once such leave to appeal is granted, the court of appeals 'is not restricted to a decision of the question of law which in the district judge's view was controlling' [citing cases] * * *. [J]udicial economy requires that we address ourselves not only to the question posed" but to a related question (506 F.2d at 660).

Clearly, this Court has power to consider on this appeal whether plaintiff,—a resident citizen who bought his stock as an insider three weeks before the public offering, knowing of an SEC order which barred the sale to him,—may represent a class over 99.6% of which consists of non-resident aliens; an issue closely related to the question of subject matter jurisdiction, the extraterritorial reach of the securities laws, and whether Congress intended to protect non-resident aliens in their purchase abroad of stock of a foreign corporation.

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Respectfully submitted,

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